

# Report of the auditor-general to the Gauteng Provincial Legislature and the council on the City of Johannesburg Metropolitan Municipality

## Report on the audit of the consolidated and separate financial statements

### Opinion

1. I have audited the consolidated and separate financial statements of the City of Johannesburg Metropolitan Municipality (CJMM) and its subsidiaries (the group) set out on pages xx to xx, which comprise the consolidated and separate statement of financial position as at 30 June 2017, the consolidated and separate statement of financial performance, the statement of changes in net assets, the cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the group as at 30 June 2017, and its consolidated and separate financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2016 (Act No. 3 of 2016) (DoRA).

### Basis for opinion

3. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.
4. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) together with the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

### Key audit matters

6. Key audit matters are those matters that, in my professional judgement, were of most significance in my audit of the current period. These matters were addressed in the context of my audit of the consolidated and separate financial statements as a whole and in forming my opinion thereon and I do not provide a separate opinion or conclusion on these matters.

Key audit matter	How the matter was addressed in the audit
<p><b>Significant difficulties encountered in obtaining information requested for audit purpose</b></p> <p>The engagement letter signed with the accounting officer agreed to provide requested documents within three working days. The municipality was unable to provide in some cases the requested documents within the agreed time. These significant difficulties adversely impacted the allocated time for audit execution and the evaluation of audit evidence. Accordingly, the significant difficulties in providing requested information and the impact thereof, is considered a key audit matter.</p>	<p>To monitor the submission of documents in response to the request for information, a tracking mechanism was set up between the municipality and senior members of the audit team. Where information was not provided timeously, concerns were escalated to leadership at various platforms as follows:</p> <ul style="list-style-type: none"> <li>• Regular audit steering committee meetings were held to assess the significant difficulties encountered in obtaining information not provided. The impact on the financial statements was assessed and reported accordingly.</li> <li>• Escalation of significant difficulties encountered in obtaining information to the accounting officer and those charged with governance during status of records review; and</li> <li>• Submitting progress reports to the accounting officer on a regular basis.</li> </ul> <p>I am satisfied that all material outstanding information has been provided and sufficient time was available to assess and report where applicable.</p>
<p><b>Revenue recognition</b></p> <p>Revenue from service charges for water and electricity, as disclosed in note 36 in the consolidated annual financial statements, was recognised based on actual meter readings or estimates of consumption. The revenue is recognised by City Power Johannesburg and Johannesburg Water, who are the municipal entities responsible for billing service charges.</p> <p>Revenue recognition for water and electricity service charges has been identified as a key audit matter due to the significant judgement applied in calculating</p>	<p>My procedures included the following:</p> <ul style="list-style-type: none"> <li>• Understanding and evaluating the flow of information, the information technology (IT) system and the controls relating to the meter reading process, the billing process and the systems interface process, which included involving my IT audit specialists.</li> <li>• Identifying the significant risks associated with service billing and designing specific procedures to address the risks identified.</li> <li>• Performing substantive test of detail using computer assisted audit</li> </ul>

<p>the estimations of consumption used and the significant volume of transactions processed and interfaced through a complex information system, creating a risk that revenue is incorrectly recognised at entity and group level.</p>	<p>techniques by IT audit specialists on the water and electricity consumption billed to identify estimations used, that exceeded the City's by-laws.</p> <ul style="list-style-type: none"> <li>• Performing substantive tests of detail on a sample basis on the estimation and meter reading process.</li> <li>• Performing procedures to determine the appropriateness of assumptions made by management to determine the estimate.</li> <li>• Physical inspection of a sample of meter readings to validate the meter readings captured.</li> <li>• I further assessed the adequacy of disclosures in respect of revenue by reference to the applicable accounting standards.</li> </ul> <p>I found that manual and IT controls were designed, however these controls were not adequately implemented and did not operate effectively throughout the year. I found that the significant judgement made by management in calculating the estimate was reasonable. My substantive procedures revealed that the extent of estimated readings were significant, resulting in material adjustment journals post year end and amendments in the two separate entities' and consolidated annual financial statements. I was thereafter satisfied that the revenue recognised was fairly stated.</p>
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### **Emphasis of matters**

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Restatement of corresponding figures**

8. As disclosed in note 52 to the consolidated and separate financial statements, the corresponding figures for 30 June 2016 have been restated as a result of errors discovered in the financial statements of the group for the year ended 30 June 2017.

### **Material uncertainties**

9. With reference to note 51 to the consolidated and separate financial statements, the municipality is the defendant in various lawsuits. The outcome of these matters cannot presently be determined and/or reliably measured; therefore, no provision for any

liabilities that may result has been made in the consolidate and separate financial statements.

#### **Material impairments**

10. As disclosed in note 10 to the consolidated and separate financial statements, the consumer debtors' balance has been significantly impaired. The allowance for impairment of consumer debtors amounts to R12 507 780 000 (2015-16: R10 243 611 000) which represents 68% (2015-16: 66%) of total consumer debtors. The contribution to the provision for debt impairment was R3 618 406 000 (2015-16: R2 510 119 000).

#### **Material electricity losses**

11. As disclosed in note 44 to the consolidated and separate financial statements, material losses amounting to R1 970 946 000 (2015-16: R2 260 114 000) were incurred which represent 18% (2015-16: 23%) of total electricity purchased. Technical losses amounted to R878 234 000 (2015-16: R906 280 000). Non- technical losses amounted to R1 092 712 000 (2015-16: R1 353 834 000) and were due to theft, bypass of meters, illegal de-calibration of meters and damaged.

#### **Material underspending of the capital budget**

12. As disclosed in the appropriation statement, the municipality has materially underspent their capital budget to the amount of R2 177 620 000 which represents 22% of the capital budget.

#### **Transfer of functions**

13. As disclosed in note 64 to the consolidated and separate financial statements, the initial accounting of the transfer of function between the CJMM and the Metropolitan Trading Company was incomplete as at 30 June 2017 and the assets acquired from the transfer of function were recognised at provisional amounts.

#### **Other matters**

14. I draw attention to the matter below. My opinion is not modified in respect of this matter.

#### **Unaudited disclosure notes**

15. In terms of section 125(2)(e) of the MFMA, the group is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the consolidated and separate financial statements and accordingly I do not express an opinion thereon.

#### **Responsibilities of the accounting officer for the consolidated and separate financial statements**

16. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

17. In preparing the financial statements, the accounting officer is responsible for assessing the CJMM's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless there is an intention either to liquidate the group or to cease operations, or there is no realistic alternative but to do so.

### **Auditor-general's responsibilities for the audit of the financial statements**

18. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

19. A further description of my responsibilities for the audit of the financial statements is included in the annexure to the auditor's report.

### **Report on the audit of the annual performance report**

#### **Introduction and scope**

20. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected programmes presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.

21. My procedures address the reported performance information, which must be based on the approved performance planning documents of the group. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

22. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected programmes presented in the annual performance report of the group for the year ended 30 June 2017:

Programmes	Pages in the annual performance report
Programme 1: Sustainable services cluster	x – x
Programme 2: Economic growth cluster	x – x
Programme 4: Good governance cluster	x – x

23. I performed procedures to determine whether the reported performance information was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

24. The material findings in respect of the usefulness and reliability of the selected programmes are as follows:

### **Programme 2: Economic growth cluster**

25. I was unable to obtain sufficient appropriate audit evidence for the reported achievements of the indicators listed below. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of these indicators.

Performance indicator	Reported achievement
Number of community work opportunities created	18 703
Number of jobs created city-wide	25 503
% implementation of consolidated green economy	72%

### **Programme 4: Good governance cluster**

#### **% spent on level 1 broad-based black economic empowerment procurement system for all tenders city-wide**

26. The systems to enable reliable reporting of the indicator were not adequately designed and implemented as required by the Framework for managing programme performance information. There were no processes in place to ensure that information was collected consistently throughout the financial year. As a result, only the performance for the CJMM was reported while the key performance indicator requires actual performance to be reported for CJMM and its' entities. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of the indicator. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of 69% spent on level 1 broad-based black economic empowerment procurement system for all tenders city-wide.

27. I did not identify any material findings on the usefulness and reliability of the reported performance information for the following programme:

- Programme 1: Sustainable service cluster

## Other matters

28. I draw attention to the matters below.

### Achievement of planned targets

29. Refer to the annual performance report on pages x to x for information on the achievement of planned targets for the year and explanations provided for the under achievement of a significant number of targets. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs x to x of this report.

### Adjustment of material misstatements

30. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of the following programmes:

- Programme 1: Sustainable services cluster
- Programme 2: Economic growth
- Programme 4: Good governance cluster

31. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

## Report on the audit of compliance with legislation

### Introduction and scope

32. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the group with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance

33. The material findings on compliance with specific matters in key legislations are as follows:

### Annual financial statements

34. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of assets, liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

## Expenditure management

35. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) the MFMA.
36. Effective steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The value of R3 073 269 000, as disclosed in note 56 to the financial statements, is not complete as management was still in the process of quantifying the full extent of the irregular expenditure. The majority of the disclosed irregular expenditure was caused by non- compliance with the Municipal Supply Chain Management Regulations (SCM regulation).

## Budgets

37. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R674 653 000, as disclosed in note 55 to the financial statements, in contravention of section 62(1)(d) of the MFMA.

## Consequence management

38. Some of the irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

## Procurement and contract management

39. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c).
40. Some of the quotations were accepted from bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c). Similar non-compliance was also reported in the prior year.
41. Some of the contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations. This non-compliance was identified in the procurement processes for the Systems, Applications and Products (SAP) upgrade.
42. Some of the contracts were awarded to bidders and some of the quotations were accepted from bidders based on preference points that were not allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) and its regulations. This non-compliance was identified in the procurement processes for the SAP upgrade.
43. Bid documentation for procurement of commodities designated for local content and production, did not stipulate the minimum threshold for local production and content as required by Preferential Procurement Regulation 9(1).

44. Some of the commodities designated for local content and production, were procured from suppliers who did not submit a declaration on local production and content as required by Preferential Procurement Regulation 9(1).
45. Persons in the service of the municipality and whose close family members who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of code of conduct for councillors and the code of conduct for staff members and councillors issued in terms of the Municipal Systems Act,2000 (Act No. 32 of 2000). Similar non-compliance findings were reported in the prior year.
46. Awards were made to providers who were in the service of other state institutions or whose directors or principal shareholders were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44.
47. Contracts were extended or modified without the approval of a properly delegated official, in contravention of SCM regulation 5.
48. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.

#### Revenue management

49. An adequate management, accounting and information system which accounts for revenue when earned was not in place, as required by section 97(1)(h) of the MFMA.

#### Other information

50. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the consolidated and separate financial statements, the auditor's report thereon and those selected programmes presented in the annual performance report that have been specifically reported on in the auditor's report.
51. My opinion on the consolidated and separate financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
52. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated and separate financial statements and the selected programmes presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
53. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate, however, if it is corrected this will not be necessary.

## Internal control deficiencies

54. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.

### Leadership

55. The accounting officer did not adequately exercise oversight responsibility regarding financial and performance reporting and compliance with legislation. The municipality did not have sufficient monitoring controls to ensure that financial and performance reports submitted for audit were accurate and complete.

### Financial and performance management

56. Senior management did not implement adequate control disciplines over financial and performance reporting and compliance with key legislation. There was a lack of a proper records management system that could support the information reported in the consolidated and separate financial statements and annual performance report and as a result material errors and omissions were identified during the audit process.

### Governance

57. Internal audit processes did not always identify internal control deficiencies and recommend appropriate corrective action effectively. This resulted in significant and recurring control deficiencies relating to the preparation of financial and performance reports and compliance with legislation.

## Other reports

58. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the group's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.

## Investigations

59. Two hundred and fifty cases of alleged irregularities relating to financial misconduct, fraudulent acts, theft and non-compliance were investigated during the financial year. The majority of these cases were investigated internally by the group's forensic department. All the cases are in progress and are planned to be issued in the following financial year.

*Auditor - General*

Johannesburg

31 December 2017



*Auditing to build public confidence*

## Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the consolidated and separate financial statements, and the procedures performed on reported performance information for selected programmes and on the group’s compliance with respect to the selected subject matters.

### Financial statements

2. In addition to my responsibility for the audit of the consolidated and separate financial statements as described in the auditor’s report, I also:
  - identify and assess the risks of material misstatement of the consolidated and separate financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
  - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the group’s internal control.
  - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
  - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the consolidated and separate financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the CJMM’s ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the consolidated and separate financial statements. My conclusions are based on the information available to me at the date of the auditor’s report. However, future events or conditions may cause a group to cease to continue as a going concern.
  - evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
  - obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the consolidated financial statements. I am responsible for the direction, supervision and performance of the group audit. I remain solely responsible for my audit opinion

## **Communication with those charged with governance**

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and where applicable, related safeguards.